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# Commonwealth of Kentucky Department of Revenue v. Kuhlman Corporation and Kentucky Board of Tax Appeals

Appellee's Brief 1975-SC-0113

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**KYSC1975-SC-0113-02**

[E7BC87DD-934A-4495-995C-6CA0714CED18]

{135130}{54-130726:124934}{042875}

# **APPELLEE'S BRIEF**

4659

# COURT OF APPEALS OF KENTUCKY

File No. 75-113

COMMONWEALTH OF KENTUCKY  
DEPARTMENT OF REVENUE - - Appellant

*versus*

KUHLMAN CORPORATION and  
KENTUCKY BOARD OF TAX APPEALS - Appellees

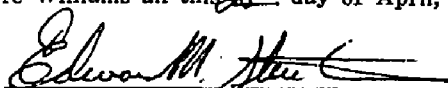
APPEAL FROM FRANKLIN CIRCUIT COURT  
HONORABLE SQUIRE WILLIAMS, JUDGE

## BRIEF FOR APPELLEE

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This is to certify that a copy of the foregoing brief has been served on the adverse parties by mailing copies to Attorneys for Appellant, Commonwealth of Kentucky Department of Revenue, William S. Riley, Assistant Attorney General, Kentucky Department of Revenue, Frankfort, Kentucky 40601, and Glenn McDonald, 401 Kentucky Home Life Building, Louisville, Kentucky, to Attorney for Appellee, Kentucky Board of Tax Appeals, Honorable Ed W. Hancock, Attorney General of the Commonwealth of Kentucky, Frankfort, Kentucky 40601, and the Trial Judge, the Honorable Squire Williams all this 24 day of April, 1975.



*Attorney for Appellee, Kuhlman  
Corporation*

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## **QUESTIONS PRESENTED**

**I. The Order, Decision and Award of the Board of Tax Appeals Was Entirely in Conformity With the Law and the Board Properly Found That the Computer Was Used Directly in Manufacturing and Exempt From Sales and Use Tax.**

**II. The Transcript of Evidence Fully Supports the Finding of Fact by the Board of Tax Appeals.**

**III. The Lower Court's Treatment of the Pleadings in a Summary Manner Was Governed by KRS 131.370(3) Not by Rule 56.04 of the Rules of Civil Procedure.**

# COURT OF APPEALS OF KENTUCKY

File No. 75-113

---

COMMONWEALTH OF KENTUCKY,  
DEPARTMENT OF REVENUE - - *Appellant*

*v.*

KUHLMAN CORPORATION and  
KENTUCKY BOARD OF TAX APPEALS - *Appellees*

---

APPEAL FROM FRANKLIN CIRCUIT COURT  
HONORABLE SQUIRE WILLIAMS, JUDGE

---

## BRIEF FOR APPELLEE

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*May it please the Court:*

### STATEMENT OF THE CASE

This action comes before the Court of Appeals on Appeal from a decision of the Franklin Circuit Court, Honorable Squire Williams, Judge, sustaining the decision of the Appellee, Kentucky Board of Tax Appeals, entered on the 8th day of January, 1974.

The Board of Tax Appeals (the Board), after a full hearing on the matter held before the Board in June, 1972, decided, based on factual conclusions supported by the evidence submitted at the hearing (copies of which are included in the transcript of record before the Court), as well as consideration of the briefs of

Counsel submitted in connection with the matter, that a computer system installed at the facility of the Appellee, Kuhlman Electric Corporation (Appellee Kuhlman) was used directly in the manufacturing of the products of Appellee Kuhlman and was exempt from assessment of sales and use tax.

The controversy arose from a final order of the Appellant determining that sales and use tax under KRS Chapter 139 was collectible and owed by Appellee Kuhlman for a computer purchased by the Appellee Kuhlman for the sum of FOUR HUNDRED SIXTY THREE THOUSAND, NINE HUNDRED THIRTY DOLLARS AND NO CENTS (\$463,930.00) for which use tax in the amount of TWENTY THREE THOUSAND ONE HUNDRED NINETY SIX DOLLARS AND FIFTY CENTS (\$23,196.50) was assessed.

### *ISSUE #1*

#### *“IS THE COMPUTER SYSTEM SUBJECT TO SALES TAX?”*

“As shown by the testimony and evidence herein, the computer and auxiliary equipment are used primarily and directly in the manufacturing process to direct the operation of manufacturing equipment located in Appellant’s (Appellees here) plant and used producing Appellant’s (Appellees here) goods, principally transformers. It was established that 56.5% of the computer’s time is allocated toward the production of its product.

“Without elaborating further upon the subject, the Board takes notice of a now common knowledge of the essential and sophisticated use of computer systems for the efficiency of manufacturing pro-

cesses and adjudges that \$463,930.00 expended for the computer system herein was not subject to sales tax".

The Board having heard all of the evidence and examined exhibits presented by the Appellee, made a *factual determination that the computer is used directly in the manufacturing process* so Appellee Kuhlman should be exempt from payment of sales and use tax in connection with the purchase thereof.

The matter was submitted to the Franklin Circuit Court, Honorable Squire Williams, Judge pursuant to the provisions of KRS 131.370 which limits the reviewing Court to four specific areas on which review is to be based solely on the record before the Board, KRS 131.370 (3) further requires the reviewing Court to treat the matter in summary fashion. Based on the evidence before it, the Franklin Circuit Court affirmed the decision of the Board.

For reasons stated hereinafter, it is submitted that the decision of the Board, as affirmed by the Franklin Circuit Court, was entirely correct and the decision of the Franklin Circuit Court was entirely within the authority granted under KRS 131.



## ARGUMENT

### **I. The Order, Decision and Award of the Board of Tax Appeals Was Entirely in Conformity with the Law and the Board Properly Found That the Computer Was Used Directly in Manufacturing and Exempt From Sales and Use Tax.**

The Legislature provided in KRS 139.480 that certain property would be exempt from the sales and use tax levied by KRS Chapter 139. The purpose of this exemption was to encourage the growth and development of commerce and industry within the Commonwealth of Kentucky, and to that end, sub-paragraph (8) provides:

“Machinery for new and expanded industry will be exempt from the application of the sales and use tax.

The enabling Legislation KRS 139.170 provides: ‘Machinery for new and expanded industry shall mean that machinery used directly in the manufacturing process, which is incorporated for the first time into plant facilities established in this State, and which does not replace machinery in such plants.’ ”

The Board found that the computer system was purchased by Appellee during the period 1968-1970 at a total cost of FOUR HUNDRED SIXTY THREE THOUSAND, NINE HUNDRED THIRTY DOLLARS AND NO CENTS (\$463,930.00). The equipment was purchased new, and was installed for the first time in Appellee’s plant facility established in this State and did not replace machinery in such plant.

KRS 139.480 provides broad statutory authority for the exemption of certain types of equipment from sales and use tax. The exemption is further defined in KRS 139.170 and Department of Revenue circular SU23 which provide specific requirements for machinery to qualify for exemption from sales and use tax.

These requirements of Circular SU23 in the relevant period provided that exempt equipment:

- 1.) Must be machinery;
- 2.) Must be used directly in the manufacturing process;
- 3.) Must be incorporated for the first time at the plant facility established in this State; and
- 4.) Must not replace other machinery.

The Appellant in its appeal, does not question requirements 1, 3, and 4, but only Questions whether the equipment is used directly in the manufacturing process.

Contrary to Appellant's position, the Board found that under the applicable Statutes and Regulations of the Appellant Department of Revenue the computer system does qualify as machinery used directly in manufacturing.

For reasons stated hereinafter, Appellee submits that the conclusion of the Board of Tax Appeals was entirely correct and that the computer is used directly in the manufacturing process and is a principal and integral element in the Appellee Kuhlman's manufacturing process.

Appellant, at page 4 of its brief properly concedes that some computers are exempt from sales and use tax. Thus the question is one of degree rather than kind.

Appellant then relies on out of context statements from the transcript of record before the Board to indicate that the computer is utilized for purpose other than manufacturing. Appellee Kuhlman does not deny that the computer is also used for purposes other than manufacturing; however, in its argument, the Appellant overlooks the fact that the Board found that the computer is used directly in manufacturing operations 56.3% of this time and Appellant apparently does not challenge this fact. The rule adopted by both Appellant and the Board is that it is the dominant use of the equipment which controls in the question of exemption *Crescent Paper Tube Company v. Department of Revenue* Order No. K'78 of the Kentucky Board of Tax Appeals. In this case the dominant use of the computer is clearly in manufacturing. Thus the principal question is whether the Board erred in holding that the computer is utilized *directly* in the manufacturing process. The portions of the transcript quoted by Appellant relate principally to what the computer does the rest of the time.

Referring now to additional testimony at the hearing which establishes the necessity for the computer in the manufacturing operation (Transcript, page 15, of the Testimony of Mr. George Clark, controller of the Appellee's plant) :

“Q. 61. In your opinion as the controller, does the use of the computer improve the efficiency so you can operate a plant where you have a mixed customer allocation such as this?

A. Yes.

Q. 62. Would you explain that?

A. We would be unable, I believe, to fully compete in our industry if we did not have this computer. It enables us to know how we are competing instead of the operation being a shot in the dark.

Q. 63. Are you familiar with what your competitors—or what their installation of their facilities is?

A. Generally speaking.

Q. 64. Do many of them have computer controlled operations such as yours?

A. Yes.”

The uncontroverted testimony considered by the Board clearly establishes that the computer from the beginning was necessary to provide competitive operation of the facilities used in Appellee’s manufacturing process.

Regardless of other testimony which supports Appellee’s position that the computer is actually used directly in the manufacturing operation at least 56.5% of the time, it is submitted that the foregoing uncontroverted testimony clearly establishes sufficient basis for the exemption, to wit: to enhance the competitive position of industry within the State.

This Court in *Commonwealth ex rel., Luckett v. WLEX-TV*, 438 S. W. 2d 520, recognized that the purpose of the statute exempting machinery for new and

expanded industry is to enhance the competitive position of the State and expressly held:

“The ultimate purpose of the exemption is to enhance the competitive position of this State as against other states in encouraging the location and expansion of the industries whose ‘manufacturing’ processes require volume employment of people.”

Also, Paragraph 11(4) of Circular SU23 of the Appellant provides for exemption of machinery which is:

“ . . . used exclusively for quality control of in-process material or the *efficient operations of machinery*. Examples are air cooling or air conditioning systems, control panels, exhaust systems, or similar activities.” (Emphasis added.)

Accordingly, it is the position of Appellee Kuhlman that regardless of the other facts considered by the Board which also fully support Appellee’s position, the facts above conclusively establish that Appellee Kuhlman installed the computer system at the inception of the plant with a view to overall manufacturing efficiency and to deny the exemption is inconsistent with the appropriate statutes and regulation of the Appellant.

Turning now to the summary of the evidence regarding the use of the computer in the manufacturing process on a regular and continuing basis to direct machinery operations on the manufacturing floor as to particular operations to be performed on specific pieces of equipment and to instruct movement of work in

process through various manufacturing stations, the Court can consider the transcript of evidence inter alia pages 12, § 13:

“Q. 46. Mr. Clark, you mentioned that the principal use of the computer was in manufacturing. Could you broadly describe the manufacturing use of the computer in the manufacturing process?

A. The computer issues a parts list accompanied by a labor routing to the factory on an interim basis instructing pattern affecting what parts they are to draw and assemble—

Q. 47. Excuse me. By drawing you mean taking out?

A. Taking from storage and assemble into the product and also *instructs the operator as to what operation he should perform, how much it takes to do that and how many pieces he needs to to this.* (Emphasis added.)

Q. 48. Does the computer receive any reports back from the people on the floor as to what they are doing? *Is the system designed to feedback information from the floor to the computer?* (Emphasis added.)

A. Yes, it is.”

Again at page 16:

“Q. 55. What do the, in summary what do the instructions tell the manufacturing area?

A. Well, as I mentioned before, it indicates the name of the material required for a given unit of shop orders, *the material required and also the labor functions that they are to perform.* (Emphasis added.)

Q. 56. I see, and now, the system you said was designed to receive feedback from the manufacturing facility. How would this be done?

A. In the form of cards. The laborer, each laborer is required to write on his labor ticket as he works the specific shop order he is working on, the work center he is working in and the operation he is performing. He reports that on the card and feeds that back to the computer. That tells us where at any time, this item is and the stage of production.

Q. 57. Does the computer have the capacity to recognize when a certain manufacturing function is behind time or ahead of time or make some notation such as this?

A. Yes."

Thus at pages 24-26 (Testimony of Mr. Clark):

"Q. 16. Now, let me interrupt at this point. *Until the people on the manufacturing floor get their instructions, do they know what to do?*

A. *No, they have no prior knowledge.* (Emphasis added.)

Q. 17. Does the material needed to assemble the transformer, you indicate this is in the final assembly operation, come to them without their previous knowledge that it is coming?

A. Yes it does.

Q. 18. So isn't your testimony then that in the absence of the sheet they will sit around with a bunch of spare parts?

A. I would like to think not but in all likelihood, that's what would occur. The body of the report indicates five separate operations and each operation contains a labor number and this same labor number will be recorded by the operator on his labor ticket.

\* \* \* \* \*

Q. 23. Does the computer system have the capacity to recognize the problems in the plant and

determine whether they are ahead of or behind schedule based on this information?

A. Yes it does.

Q. 24. Let me ask another question. You say there are a number of operations indicated on the sheet?

A. Yes.

Q. 25. Are they in any particular sequence?

A. Yes, sir. *They are in the sequence in which they have to be performed.* (Emphasis added.)

Q. 26. So the instruction has the sequence of the operation of the plant.

A. This is correct."

Thus at pages 29-30:

"Q. 37. Let me ask you in summary, what output is the computer designed to have with instructions to manufacturing?

A. Overall it would be the facilitating of the production cycles to the extent of *providing information to each department within the plant on a timely and accurate basis upon which the operators and men in the shop can perform their particular jobs.*

Q. 38. Does it instruct them what jobs to perform?

A. *Instructs each job, the detailed component parts, the part number, the particular operation to be performed, how much time they are allowed, and the furthermore requiring them to return information back to the computer so that it can keep a log or monitor the cycle for successive steps.* (Emphasis added)

Q. 39. Now, under the system as designed, do the people in the floor or on the manufacturing floor perform any functions until they are instructed to do so by the computer?



A. No. Actually the start of their work is keyed by the generation of raw material and parts list when materials are pulled from the storage area in lots of the particular quantities for shop order identifying them as such and taken to the department for assembly or specification. It's at that stage that they begin to perform the process.

Q. 40. In fact, don't they perform their manufacturing process according to instructions given by the computer?

A. Yes."

From the foregoing excerpts from the testimony at the hearing in the subject matter, which are uncontroverted, it can be seen that the computer does actually and directly control the processing steps in the manufacture of transformers at Appellee Kuhlman's facility.

Further, in support of its position and the decision of the Board and the Franklin Circuit Court, Appellee Kuhlman directs the attention of the Court to Appellant's Revenue Circular SU-23 in effect at the time of the installation of the computer which gives examples of exemptions for machinery involved in contributory manufacturing processes, including electrical and similar equipment used directly in the operation of other machinery which is used directly in the manufacturing process<sup>1</sup> and further provides an exemption for machinery used exclusively for quality control of in process material for the efficient operation of machinery.<sup>2</sup>

---

<sup>1</sup>II. (3) Electrical machinery and similar equipment used directly in the operation of other machinery which is used directly in the manufacturing process.

<sup>2</sup>II. (4) Machinery used exclusively for quality control of in process material or the efficient operation of machinery, for examples, air cooling or air conditioning systems, control panels, exhaust systems, and similar activities.

The Court will note for example, with respect to water cooling systems and the cooled water itself, that these are not the final product but usually only indirectly affect the operation of the manufacturing units by cooling the manufacturing equipment, thereby improving efficiency or operability. It is clear that the computer under consideration here, performing its principal function of controlling the operations of the plant, is much more involved in the manufacturing process than is a facility for cooling equipment which is expressly exempted from use tax by the Department Regulations. Also the computer here is clearly more directly involved in the manufacturing system than an exhaust fan would be.

The Appellant apparently takes the position that because the computer is not directly wired into the operating equipment it is not used directly in the manufacturing process. In this the Appellant is clearly in error because nowhere is there such a requirement either in the statute or in the Appellant's own Regulations particularly because such an interpretation is clearly contrary to Appellant's own Regulations which allow exemption of equipment such as exhaust fans which are not directly connected to manufacturing equipment. Appellee Kuhlman submits that such a distinction as urged by Appellant, is entirely fictitious and without any basis in logic or in law.

Moreover, Appellee further suggests that the question of whether the computer is directly used in the manufacturing process is determined from the overall function of the computer, which is to direct the manu-

facturing process step by step, stage by stage, and to provide distinctive instructions to persons performing the operation as the operations are to be performed.

Furthermore, if the Appellant has taken the position that the fact that the computer is not physically connected to the manufacturing equipment is a distinguishable factor, the position is inconsistent with the position of the Department taken in the matter of *Green and Web Lumber Co. v. Department of Revenue*, Kentucky Board of Tax Appeals, No. K 71-4-5. The file in that case shows that the Department agreed that an attachment was used directly in the manufacturing process and conceded that the equipment was exempt from sales tax where the attachment was an arrangement where a string was suspended above a saw table with a light above the string so the light shining over the string cast a shadow over the lumber indicating the line along which the lumber was to be cut.

In this case, the transcript is replete with uncontradicted testimony establishing that the computer system is essential to the efficient operation of the plant, and in fact, the use of the computer was one of the principal factors considered in a decision to build a facility and locate it in Versailles, Kentucky.

The Appellees suggest that Appellant's reliance on the decision in *Commonwealth ex rel., Lockett v. W.L.E.X., TV, Inc.*, 438 S. W. 2d 520, at page 521, is misplaced inasmuch as the Court in that case was considering primarily, the question of what is "manufacturing." The question of use "directly" in manufacturing was not in issue as in the present case. Nowhere

has the Appellant taken the position that the Appellee is not "manufacturing."

In support of its position, Appellant would have the Court adopt an unusually strained definition of the work "directly," which cannot even be inferred from the definition cited by Appellant. Here the evidence is uncontroverted that the computer does direct each operation to be performed in the plant and to say it is not directly involved is to entirely misconstrue the evidence upon which the decision of the Board was based.

Accordingly, Appellant submits that neither the Board nor the Franklin Circuit Court has improperly expanded the definition of the term "directly" as used in the statute or the regulations.

## **II. The Transcript of Evidence Fully Supports the Finding of Fact of the Board of Tax Appeals.**

For reasons given hereinbefore, it is submitted that the findings of fact of the Board, which are based on uncontroverted testimony presented at the hearing in the subject matter, conclusively establish that the dominant use of the computer is directly in manufacturing so that the decision of the Board, affirmed by the Franklin Circuit Court, is correct.

To establish error, the Appellant bears a heavy burden. KRS 131.370(3) provides that Judicial review of decisions of the Board shall be limited to determining whether or not:

- “(a) The Board acted without or in excess of its powers;

- (b) The order, decision or award was procured by fraud;
- (c) The order, decision, or award is not in conformity to the law; and—
- (d) If findings of fact are in issue, whether such findings of fact support the order, decision or award.”

Here the Appellants apparently are concerned only with subparagraph (d) in stating that the evidence does not support the findings of fact.

It has been held, *Trimble County Board of Supervisors, etc. v. Milliken*, 438 S. W. 2d 524, that the legislature by the statute intended to limit review of orders of the Board as to whether findings are supported by substantial evidence. Thus it has been held *Taylor v. Coblin*, 461 S. W. 2d 78 (1970), that if there is *any* substantial evidence to support action of an administrative agency, the action cannot be found to be arbitrary. In this case, the Board was presented with substantial, detailed and uncontroverted evidence showing that the computer in question actually directs the individual operator step by step, in the fabrication of the Appellee's product and concluded, as a decision of fact, that the computer is used directly in the manufacturing process. In this regard, findings of fact by an Administrative Board should not be disturbed when the Board had jurisdiction and acted honestly, impartially and not arbitrarily *Bandeen v. Howard*, 299 S. W. 2d 249 (1957). Nowhere has the Appellant even suggested that the Board acted improperly.

Furthermore, the Appellant does not dispute the evidence but merely quarrels with the result which, unless arbitrary, was entirely within the jurisdiction of the Board.

For the foregoing reasons, Appellees submit that the decision of the Board was correct, was supported by substantial evidence, and should be affirmed.

### **III. The Lower Court's Treatment of the Pleadings in a Summary Manner Was Governed by KFC 131.370(3) Not by Rule 56.04, of the Rules of Civil Procedure.**

The action in the Franklin Circuit Court was an action for Judicial review of an order of an administrative agency, the Kentucky Board of Tax Appeals. KRS 131.370, which authorizes Judicial review of the Board of Tax Appeals decisions, also prescribes the procedure and scope of such review.

KRS 131.370 (3) limits the area of Judicial Review to four specific areas delineated by subsections (a), (b), (c), and (d), and provides that "no new or additional evidence shall be introduced . . . The Court shall otherwise hear the cause upon the record as certified by the Board. . . ."

By virtue of Appellant's own petition for review, the Circuit Court was further limited in its scope of review to only subsections (c) and (d) of KRS 131.370 (3). That same section (3) requires that the reviewing Court "shall dispose of the cause in a summary manner", the review being limited to a review of the Board's certified record to determine the issue re-

stricted in subsections (c) and (d). No trial de novo is authorized. No new evidence was admissible and the issues raised in Appellant's petition for review were fully argued in memoranda submitted by both parties.

Appellant contends that in treating the Appellee's Motion to dismiss as a Motion for Summary Judgment the Circuit Court should have proceeded under CR 56.04, entitled "case not fully adjudicated on Motion". That section by its own terms is applicable only "if . . . Judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary. . . ." The 1952 Committee notes state that "56.04 provides for a mandatory order in the nature of a pre-trial order in the event the Court *cannot fully adjudicate* the case on the Motion for Summary Judgment" (emphasis added). The Circuit Court, in reviewing the order of an administrative agency, *could* fully adjudicate the cause in summary manner. Moreover, by virtue of the limits placed upon the scope of its judicial review by KRS 131.370, the Circuit Court could do no more. The issue had been specifically limited by the statute and Appellant's petition for review, all admissible evidence was before the Circuit Court in the form of the Board's certified record, and the complete arguments of both parties had been heard in their memoranda. CR 56.04 is not applicable because there was no need of a "pre-trial order" in that KRS 131.370 (3) required the cause to be "disposed of in a summary manner", and the cause was by its nature fully adjudicable.

**CONCLUSION**

The Appellees respectfully prays this Court to affirm the decision of the Franklin Circuit Court which affirmed the findings and final order of the Board.

Respectfully submitted,

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